MONTGOMERY & ANDREWS

J. SCOTT HALL
Cell: (505) 670-7362
Email: shall@montand.com
Reply To: Santa Fe Office
www.montand.com

July 6, 2009

Florene Davidson
New Mexico Oil Conservation Commission
1220 S. St. Francis Drive
Santa Fe, NM 87505

Hand Delivered

Re: In the Matter of the Application of Energen Resources Corporation to Amend the Cost Recovery Provisions of Compulsory Pooling Order No. R-1960, to Determine Reasonable Costs, and for Authorization to Recover Costs from Production of Pooled Mineral Interests, Rio Arriba County, New Mexico, NMOCC Case No. 13957 De Novo

Dear Ms. Davidson:

On Behalf of Energen Resources Corporation, enclosed are an original and six copies of Applicant's Proposed Findings and Conclusions.

Also enclosed is an extra copy for file confirmation and return.

Thank you.

Very truly yours,

Karen Williams

Karen Williams
Assistant to J. Scott Hall

JSH:kw
Enclosure

cc: James Bruce, Esq. w/enclosure
Mark Smith, Esq., w/enclosure
Candice Lee, Esq. w/enclosure

REPLY TO:
325 Paseo de Peralta
Santa Fe, New Mexico 87501
Telephone (505) 982-3873 • Fax (505) 982-4289

Post Office Box 2307
Santa Fe, New Mexico 87504-2307

6301 Indian School Road NE, Suite 400
Albuquerque, New Mexico 87110
Telephone (505) 884-4200 • Fax (505) 888-8929

Post Office Box 36210
Albuquerque, New Mexico 87176-6210

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ENERGEN RESOURCES CORPORATION TO AMEND THE COST RECOVERY PROVISIONS OF COMPULSORY POOLING ORDER NO. R-1960, TO DETERMINE REASONABLE COSTS, AND FOR AUTHORIZATION TO RECOVER COSTS FROM PRODUCTION OF POOLED MINERAL INTERESTS, RIO ARRIBA COUNTY, NEW MEXICO

CASE NO. 13957

APPLICANT'S PROPOSED FINDINGS AND CONCLUSIONS

A. FINDINGS.

1. Applicant, Energen Resources Corporation, ("Energen") is the operator of a Pictured Cliffs formation well located in Rio Arriba County. The well is one of a number of properties acquired in 1997 from Energen's predecessor operator, Burlington Resources. The well is subject to a compulsory pooling order issued in 1961 which pooled certain unleased mineral interests.

2. The pooling order at issue in this proceeding is Order No. R-1960, entered by the Commission in Case No. 2249 on May 5, 1961. That order established a compulsory-pooled unit (the Unit) comprising the SW/4 of Section 2, Township 25 North, Range 3 West, NMPM, in Rio Arriba County, New Mexico, as to the Pictured Cliffs formation in the Tapacito-Pictured Cliffs Gas Pool (985920). The Unit was dedicated to the Martinez Well No. 1 (API No. 30-039-06124), located 790 feet from the South line and 790 feet from the West line (Unit M) of Section 2. Southern Union Production Company, ("Supron"), the applicant in the original pooling case was designated operator.

3. Joseph A. Sommer (Sommer) was the owner of an unleased mineral interest in the S/2 SW/4 of Section 2 comprising approximately 8.33333% of the 160-acre well unit. Sommer did not contractually commit his interest to the subject well and did not otherwise elect to participate under the Pooling Order. Accordingly he became a non-consenting party, under the terms of the Pooling Order, as to his deemed working interest (7/8ths of his total interest, pursuant to NMSA 1978, Section 70-2-17). Sommer's interest was subsequently conveyed to the Joseph A. Sommer Trust and is now owned by JAS Oil and Gas Company, LLC ("JAS"), referred to collectively as "Sommer/JAS."

4. The Martinez No. 1 Well was drilled and completed by Supron in 1961. The well was operated by Supron until the well and lease were acquired by Union Texas Petroleum Corporation, ("Union Texas" or "Unicon"), which became operator of the well on approximately July 23, 1982. On approximately June 23, 1990, Meridian Oil, Inc., ("Meridian Oil"), acquired Union Texas Petroleum Corporation's interests and became

operator of the well. On July 11, 1996, Meridian Oil, Inc. merged into Burlington Resources Oil and Gas Company, ("Burlington"), and thereafter Burlington became operator of the well. In 1997, Taurus Exploration USA, Inc. acquired Burlington's interests in the well and became operator. Subsequently, on October 1, 1998, through a corporate change of name, Taurus Exploration USA, Inc. became Energen Resources Corporation. Energen continues to operate the well. [TR 20.]

5. It is not disputed that the well reached pay-out before the time Energen became operator. However, in recent years, Sommer/JAS has objected to the operating and supervision or "overhead" costs attributable to its interest in the well and Sommer/JAS has not reimbursed the operator of the well for its proportionate share of those costs.

6. In addition, Sommer/JAS failed to make arrangements for the sale of its share of gas and has refused to permit Energen to market its gas on its behalf. As a consequence, under gas balancing, the interest of Sommer/JAS has become "underproduced."

7. As an additional consequence of the non-disposition of the Sommer/JAS gas, the operator has been prevented from recouping Sommer/JAS's proportionate share of operating costs and supervision charges from production as is otherwise authorized by NMSA 1978 §70-2-17 C. Further, Sommer/JAS has taken the position that the operator may not sell its gas from the well when the Sommer/JAS working interest share is not being marketed, which would thus require that the well be shut-in.

8. By its Application in this matter, Energen requested the Division, and now the Commission, to amend Order No. R-1960 in order to allow for the pro rata reimbursement of the operator's costs of operations and supervision consistent with the current practices of the agency.

9. Energen has also sought relief pursuant to "Rule 414"[1] in order to market gas production from the well attributable to Sommer/JAS. Energen's Application accordingly requested (1) the amendment of Order No. R-1960 to include new provisions allowing for the pro rata reimbursement of the operator's costs of operations and supervision charges which may be adjusted annually, (2) further authorizing Applicant to sell the production attributable to the pooled working interest of the non-selling mineral interest owner, and (3) making such other provisions as may be proper.

10. Energen's pleadings and evidence establish that the form of the compulsory pooling order issued in 1961 is unclear and does not directly comport with the form of orders currently in use by the Division setting forth the means by which well operators may obtain reimbursement for operating costs and supervision charges. Order No. R-1960 (Energen Ex. 1) neither contains findings establishing the amount of supervision charges, nor does it expressly provide for their periodic adjustment as allowed by statute. (See *NMSA 1978 §70-2-17 C).*

[1] 19.15.24.8 NMAC

11. The unnumbered decretal portions of Order No. R-1960 contained the following provisions authorizing the operator to recover the costs of development and operation:

> *"PROVIDED FURTHER, That the proportionate share of the costs of development of the pooled unit, including a reasonable charge for supervision, shall be paid out of production by each non-consenting working interest owner and shall be 110 per cent of the same proportion to the total costs of drilling and completing the well that his acreage bears to the total acreage in the pooled unit."*

12. The relevant terms of the 1961 compulsory pooling order does not reflect the cost recovery provisions found in contemporary pooling orders, which typically provide as follows:

> *(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6000 per month while drilling and $600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.*

13. Previously, the operators up through the time Meridian/Burlington operated the well were selling gas on behalf of those working interest owners who had not made arrangements to dispose of their own share of gas.

14. By letter dated March 17, 1992, Meridian advised all of the working interest owners in the properties it operated, including the Martinez No. 1, that it would discontinue selling gas on behalf of the other working interest owners beginning on May 1, 1992 (Energen Ex. 4). By that same letter Meridian advised the non-marketing interest owners to make arrangements for marketing their gas.

15. Subsequently, by letter dated September 28, 1995, Meridian advised that its marketing affiliate, Meridian Oil Trading, Inc, would discontinue gas purchases from well working interest owners effective on December 1, 1995. The September 28, 1995 letter also requested that the operator be advised of the working interest owner's plans for disposing of its share of gas by November 1, 1995. The letter also advised that if the working interest owner has not made arrangements to sell its share of gas it would be made subject to gas balancing (Energen Ex. 5).

16. There is no evidence that Sommer/JAS ever responded to the Meridian notices or otherwise made arrangements for the disposition of its gas.

17. All of the working interest owners in the unit dedicated to the Martinez No. 1, except for Sommer/JAS, are parties to a standard industry joint operating

agreement which includes a gas balancing agreement. [TR 22, 23.] The gas balancing agreement provides that, in the event that a working interest owner fails to arrange for the sale of its share of gas produced from the Unit, the operator is authorized to sell the corresponding percentage of gas produced for its (operator's) own account. The operator must account for the quantity of gas allocable to the non-selling working interest owner out of future production, if and when that owner arranges for the sale of its gas. If the non-selling working interest owner has not recouped all of the gas to which is entitled under the terms of the gas balancing agreement when the well ceases to produce, then the operator is obligated to account to the non-selling owner in money on a basis provided in the gas balancing agreement.

18. The evidence presented at hearing demonstrated that it is the long-established custom and practice of the industry to implement gas balancing when less than all interest owners in a well have their gas sold. [TR, at 24, 26.] Doing so allows gas for marketing parties in a well to be sold and avoids the shut-in of the well when less than 100% of the interest owners have made arrangements for the disposition of their share of gas. In such situations, the accounts of selling interest owners become "overproduced" and non-marketing parties become "underproduced." When an underproduced party sells its gas, the operator often inflates its interest to allow it to "make-up" its underproduced position.

19. When Taurus/Energen assumed operations of the well in 1997, the takes and entitlements of all the interest owners were not in balance. Sommer/JAS was "over-produced." However, in the years since, because Sommer/JAS had not made arrangements for the disposition of its gas, its account became "underproduced." [TR 34.]

20. Monthly lease operating expenses continued to accrue for all of the working interest owners in the well even in those instances where a working interest owner was not marketing its gas. [TR 32, 33, 36.]

21. It is Energen's practice to continue to invoice the working interest owners for their proportionate share of lease operating expenses. [TR 32.] Energen provided a full account of all lease operating expenses for the period of time it has operated the Martinez No. 1 well. (Energen Ex. 19.) Energen's witness also testified that its lease operating expenses were reasonable. [TR 54.]

22. Sommer/JAS has not paid invoices sent to it by Applicant for operating expenses or otherwise compensated Applicant for any part of the operating expenses pertaining to the subject well and the Unit. [TR 49.]

23. Previously, Sommer/JAS had objected to a number of lease operating expenses and joint interest billings it received from Energen relating to operations of the Martinez No. 1 Well. (January 5, 1998 letter from Mr. Sommer, Energen Ex. 10). However, Sommer/JAS presented no evidence with respect to the reasonableness of the operating expenses. Consequently, at the hearing, Sommer/JAS dropped all objections to Energen's lease operating expenses. (TR 116). [conclusion]

24. The amount of the outstanding joint interest billings currently due and owing attributable to the Sommer interest is $8,975.35. This amount includes monthly charges for supervision, specifically the producing well overhead rate. [TR 49; Ex. 23.] Except for the well supervision overhead rate, the historic and current monthly lease operating expenses charged by Energen are reasonable. [TR 54.]

25. Other than lease operating expenses, JAS/Sommer continued to object to the operator's supervision, or "overhead" charges as unreasonable. (June 15, 2001 correspondence, Energen Ex. 11.) [TR 120.]

26. Energen requested an amendment to Order No. R-1960 to allow it to charge the current prevailing producing well supervision overhead rate, which the Commission determines is currently $550.00 per month for producing wells of similar depth and vintage. TR 57.]

27. This rate is in line with what is being charged by other operators in the area for similar wells. This rate should also be adjusted periodically in accordance with the then-current COPAS Bulletin AND Section III.1.A.3 of the COPAS form titled "Accounting Procedure-Joint Operations."

28. By that August 16, 2002 letter sent to Energen, Sommer/JAS asserted that, as of December 1, 1995 the operator was without any authority to sell the share of gas. Sommer/JAS also asserted that, pursuant to the pooling order, Energen had the authority to sell only those volumes of the gas sufficient to cover the "real costs of production" and further disputed the operator's authority to recover operating costs in a balancing situation. It was also asserted that Energen had no authority to sell the Sommer/JAS Trust's working interest share of gas or to balance its share of production. [TR 57; Energen Ex. 14.]

29. The practical effect of a denial of authority to implement gas balancing when one or more interest owners in a well have failed or refused to market their share of production would require that the well be shut in until arrangements have been made to market the gas of 100% of the working interest owners. Shutting-in the well would not be consistent with the custom and practice in the industry. The correlative rights of the other interest owners in the pool would be violated if the well were forced to be shut-in in such a situation. [TR 43.]

30. Energen presented evidence establishing that the Martinez No. 1 well is offset by a number of other wells also producing from the Pictured Cliffs formation operated by third-parties. (Energen Ex. 26). Energen's witness testified that shutting-in the Martinez No. 1 well could result in the impairment of its correlative rights. [TR 43, 44.]

31. In addition to its interest in the Martinez No. 1 well, Sommer/JAS owns mineral interests in the Mesaverde formation in Section 2 that are dedicated to Energen's McCroden "C" No. 1 well. The Sommer/JAS interests were not the subject of compulsory pooling. Rather, Sommer/JAS voluntarily participates in the McCroden "C"

No. 1 well pursuant to the terms of an industry standard AAPL form 610-1982 Operating Agreement signed by it in 2006. [TR 44, 78.] A Gas Balancing Agreement typically used in the industry is attached as Exhibit E to the Operating Agreement. (Energen Ex. 18). For parties participating under joint operating agreements, the custom and practice of the industry with respect to gas balancing among separate interest owners in a well is reflected by the Gas Balancing Agreement. [TR 45.]

32. The current volume of gas underproduction attributable to the Sommer/JAS interest in the Martinez No. 1 Well is approximately 7,331 Mcf. [TR 10, 11, 46; Energen Ex. 22.] Energen has paid Sommer/JAS the proceeds of sale attributable to its deemed royalty interest (1/8th of its share of production from the Unit, as provided in NMSA 1978, Section 70-2-17) and there is no controversy concerning the Sommer/JAS royalty interest. [TR 62, 127.]

33. Energen's witness testified that Energen's engineering staff determined that the Martinez No. 1 well has an estimated ultimate recovery ("EUR") of 166,000 Mcf. and at the present decline rate of three and one-half percent per year, the remaining life of the well is approximately 49 years. The testimony also established that the well is a "marginal well". [TR, 82]. Consequently, there is uncertainty whether the Sommer/JAS underproduction could be made-up during the remaining life of the well, even if its interest and takes of gas were to be inflated during the make-up period.

34. Mr. Kurt Sommer testified on behalf of Sommer/JAS and requested a wide variety of relief from the Commission. Among the relief requested, Sommer asked that the Commission order Energen to deliver at once to Sommer/JAS an in-kind volume of gas equal to the total amount of its underproduction. Sommer/JAS proposed that the gas to be delivered should come from other wells operated by Energen. It was also requested that the Commission order Energen to pay Sommer/JAS's attorneys fees. [TR 105, 113.]

35. Mr. Sommer also requested Sommer/JAS be paid for its proportionate share of the gas imbalance based on historic sales prices, together with interest at the statutory rate. [TR 105.] He also testified that Sommer/JAS does not object to Energen's operating expenses. [TR 116, 120.]

C. CONCLUSIONS.

The Commission's Jurisdiction

1. The agency's jurisdiction is not in dispute. The jurisdiction and the authority of the Division and Commission to grant the relief sought by the Application in this matter are clearly established in the Oil and Gas Act. NMSA 1978 §70-2-1 et seq. Section 70-2-11 of the Oil and Gas Act makes clear that the Division has a duty to act on the Application in this matter. That section provides:

> *"(a.) The Division is hereby empowered, and it is its duty, to prevent waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the Division is empowered to make and enforce rules, regulations and orders, and to do whatever may be*

reasonably necessary to carry out the purposes of this act, whether or not indicated or specified in any section hereof."[2]

Reimbursement of Operating Expenses and Supervision Charges

2. The terms of the 1961 compulsory pooling order, together with the applicable statute, NMSA Section 70-2-17 (C), make clear that the operator is entitled to reimbursement for operating expenses and a reasonable charge for supervision. The order provides:

> *"[T]he proportionate share of the costs of development and operation of the pooled unit shall be borne by each consenting working interest owner in the same proportion to the total costs that his acreage bears to the total acreage in the pooled unit."...The proportionate share of the costs of development of the pooled unit, including reasonable charges for supervision, shall be paid out of production by each non-consenting working interest owner."*

The compulsory pooling statute, in part, states:

> *"Such pooling order of the division shall make definite provision as to any owner, or owners who elects not to pay his proportionate share in advance for the prorate reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision..."* NMSA 1978 Section 70-2-17(C).

3. It has been the practice of the Division, and the Commission, to retain jurisdiction over its compulsory pooling orders to, among other things, resolve disputes over development and operating costs:

> *"In the event of any dispute relative to such costs, the division shall determine the proper costs after due notice to the interested parties and a hearing thereon."* Id.

4. The parties were afforded a full and fair hearing in this matter along with the opportunity to request appropriate relief.

5. The relevant terms of the 1961 compulsory pooling order does not reflect the cost recovery provisions found in contemporary pooling orders, which typically provide as follows:

[2] See, *also*, NMSA 1978, § 70-2-6; "...[The Division] shall have jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this act ...."

(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6000 per month while drilling and $600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.

6. There should be no question that the agency has ongoing jurisdiction to resolve the dispute over the operator's entitlement to reimbursement for operating expenses under the order and to establish overhead charges comporting with current industry rates for the area.

7. Accordingly, the pooling order should provide expressly that the parties incurring costs of operation of the subject well and the Unit shall be entitled to recover the proportionate share of those costs, but not exceeding such amounts as are reasonable, from a non-consenting pooled party's working interest share of production from the Unit, but solely out of such party's share of production.

8. The evidence establishes that a producing well overhead charge of $550 per month is fair and reasonable. Accordingly, the pooling order should provide for the recovery by the operator of a $550 per month supervision charge, which may be adjusted periodically for inflation in accordance with current periodic bulletins issued by COPAS (Council of Petroleum Accountants Societies). Such charges shall be made applicable retroactively and de-escalated, to provide for recovery of the producing well overhead charges allocable to the Sommer/JAS interest.

Rule 414

9. It should also be without question that the Division has jurisdiction to address the *means* by which an operator may obtain reimbursement for operating expenses and supervision charges. In this particular circumstance, Energen's invocation of Rule 414 is consistent with, and facilitates the operator's request to obtain reimbursement from an uncooperative working interest owner.

10. That the Commission deemed appropriate to promulgate Rule 414 conclusively establishes the existence the agency's jurisdiction over the subject matter of this Application and the authority to accord the relief Energen and Sommer/JAS seek.

11. The failure of Sommer/JAS to make arrangements for the sale of its gas and its refusal to allow Energen to market gas on its behalf have prevented the operator from recovering reimbursement of the proportionate share of operating costs and supervision charges attributable to the Sommer/JAS interest which the compulsory pooling order authorizes. The operation of both the compulsory pooling statute and the original pooling order is thwarted as a consequence.

12. At the same time, Sommer/JAS has challenged the operator's authority to sell gas for its own account or for any other interest owner, threatening that such sales constitute conversion, thereby placing the operator in an impossible position. The end-result of the Sommer/JAS reasoning, were it to be put into practice, would place all other interest owners at the mercy of the non-selling party and would prevent any sales from the well. Such a position directly implicates the correlative rights[3] of the operator and other interest owners. Correspondingly, under Rule 414 (now 19.15.24.8 NMAC), the Commission established a procedure in aid of its statutory mandate to protect correlative rights in such a situation:

> **19.15.24.8 Gas Sales By Less Than One Hundred Percent Of The Owners In A Well** *When there are separate owners in a well and where any owner's gas is not being sold with the well's current production, the owner may, if necessary to protect the owner's correlative rights, petition the Division for a hearing seeking appropriate relief.*

13. In the process of promulgating Rule 414, the Commission expressly recognized the industry practice of gas balancing. (See Order No. R-8361. Energen Ex. No. 25) Energen has not in this case expressly asked the Commission write a gas balancing agreement for the parties. Rather, the Commission is asked to recognize that the request for authorization to sell a portion or all of the production attributable to the pooled working interest of the non-selling mineral interest owner to enable the reimbursement of costs is consistent with long-standing industry custom and practice.

14. The form of Gas Balancing Agreement dated March 1, 2006 introduced into evidence (Energen Ex. 18) was entered into between Energen Resources Corporation as Operator and Sommer/JAS, et al. and governs the rights and obligations of the parties with respect to the marketing of gas and implementation of gas balancing for the McCroden "C" No. 1 well located on the same acreage as the Martinez Well No. 1. This Gas Balancing Agreement is representative of the custom and practices of the industry.

15. Incorporation in this Order of a Gas Balancing Agreement in the form of Energen Ex. 18 and its application to the parties is reasonable and is an appropriate way for the Commission to recognize the custom and practice of the industry and will serve to eliminate future disputes that may arise in the course of operations of the Martinez Well No. 1. The Division and the Commission in the past have adopted accepted industry forms and incorporated them into their orders to resolve disputes over drilling and operations. (See, e.g., Order No. R-9093-C; Case No. 9998; *Application of Yates Energy Corporation To Amend Division Order No. R-9093, Eddy County, New Mexico.* In the *Yates* case, the Division adopted the September 1965 version of COPAS Bulletin No. 2 addressing the allocation of well costs among diverse interest owners with variable

[3] NMSA 1978 §70-2-33 H: "[C]orrelative rights means the opportunity afforded, so far as it is practicable to do so, to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas or both in the pool, being an amount, so far as can be practicably determined and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas or both under the property bears to the total recoverable oil or gas or both in the pool and, for such purpose, to use his just and equitable share of the reservoir energy;" The Division is charged with protecting correlative rights pursuant to NMSA §70-2-11 A.

ownership by depth. The Division and Commission routinely incorporate the annual overhead adjustment provisions of that COPAS form entitled "*Accounting Procedure-Joint Operations*" in compulsory pooling orders.)

16. The agency's jurisdiction over the application in this matter has been properly invoked. Only the Division and the Commission have been charged with the specific statutory mandate to exercise jurisdiction, authority and control over oil and gas operations in this state. *See*, NMSA 1978, § 70-2-6-A; *see also Continental Oil Co. v. Oil Conservation Commission*, 70 N.M. 310, 323, 373 P.2d 809, 817 (1962). The invocation of this agency's administrative processes under the compulsory pooling statutes and Rule 414 is fully in accord with the Commission's mandate "*...to do whatever may be reasonably necessary to carry out the purposes of [the oil and gas act]....*" NMSA 1978 §70-2-11 A.

17. Energen shall provide at its cost an independent audit of the JAS/Sommer account in the Martinez No. 1 well for the period from the time Energen acquired operations of the well in 1997 to the present. The audit shall determine for the audit period (i) the current volume of underproduction based on historic prices and calculated in a manner consistent with the cash-balancing settlement procedure set forth in Section 7 of the March 1, 2006 Gas Balancing Agreement between Energen and JAS/Sommer (Energen Ex. 18) and (ii) actual operating costs for the well.

18. The audit provided for in paragraph 17, above, shall be completed within six months from the date of the Commission's Order and shall be provided to the Commission and the parties. Either party may appeal all or a portion of the audit report within thirty days of its receipt and the Commission shall retain jurisdiction over this matter accordingly.

19. Energen shall be required to account to and buy-out JAS/Sommer's then current volume underproduction based on historic prices and calculated in a manner consistent with the cash-balancing settlement procedure set forth in Section 7 of the March 1, 2006 Gas Balancing Agreement between Energen and JAS/Sommer (Energen Ex. 18).

20. Actual operating costs shall be deducted from the payment provide for in paragraph 19, above. Well overhead and supervision rates shall also be deducted at the current rate of $550 per month and de-escalated for prior periods in accordance with the table attached hereto as Exhibit 1.

21. Energen shall pay interest on the cash-balancing settlement amount in accordance with NMSA 1978 §70-10-4. For the reason that Sommer/JAS denied the operator's authority to market its gas, Energen should not be required to pay penalty interest. See NMSA 1978 §70-10-5.

22. For future production, Energen shall have the right, but not the obligation, to sell gas on behalf of Sommer/JAS and account to Sommer/JAS in accordance with the

provisions of the March 1, 2006 Gas Balancing Agreement which is incorporated into, and made a part of this Order as Exhibit 2.

23. Energen shall provide for execution by JAS/Sommer a current form of division order accurately setting forth the percentage or decimal interests of all interest owners in the Martinez No. 1 Well.

24. This Order shall supplant Order No. R-1960-A previously entered by the Division in this matter.

25. Pursuant to the application of Energen Resources Corporation, Order R-1960 is hereby amended, effective as of the date of first production from the Martinez Well No.1 (API No. 30-039-06124) in Section 2, Township 25 North, Range 3 West, Rio Arriba County, New Mexico, to include the following provision:

> Reasonable charges for supervision (combined fixed rates) are hereby fixed at $550 per month while producing, as of 2009, provided that these rates shall be adjusted annually, from 2009 forward, pursuant to Section III.I.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations" and de-escalated for prior periods. The operator is authorized to withhold from production attributable to each pooled party's deemed working interest, the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

26. The amendment of Order No. R-1961 to provide for the revisions of the well cost provisions and the adoption of a gas balancing agreement will promote the efficient and orderly operation of the subject well, will protect the rights of the pooled interest owners, will serve to prevent waste and is otherwise in the interests of conservation.

Respectfully Submitted,

MONGOMERY & ANDREWS, P.A.

By: _____

J. Scott Hall, Esq.
325 Paseo de Peralta
Post Office Box 2307
Santa Fe, New Mexico 87504
(505) 982-3873
Attorneys for Energen Resources Corporation

00090978-5

Rate Effective 4/1/XXXX	Escalation Factor	Escalated Backward =C3/(1+(B3/100))
1963	1.6	$48.90
1964	3.9	$50.80
1965	0.8	$51.21
1966	2.2	$52.34
1967	3.6	$54.22
1968	5.4	$57.15
1969	1.9	$58.23
1970	7.0	$62.31
1971	5.9	$65.99
1972	8.9	$71.86
1973	7.5	$77.25
1974	5.2	$81.27
1975	16.7	$94.84
1976	10.3	$104.61
1977	10.5	$115.59
1978	10.3	$127.50
1979	11.0	$141.52
1980	9.3	$154.68
1981	9.3	$169.07
1982	13.0	$191.05
1983	9.9	$209.96
1984	5.9	$222.35
1985	2.7	$228.35
1986	4.4	$238.40
1987	4.5	$249.13
1988	-1.4	$245.64
1989	3.3	$253.75
1990	8.1	$274.30
1991	7.2	$294.05
1992	1.5	$298.46
1993	-1.1	$295.18
1994	4.8	$309.35
1995	4.4	$322.96
1996	4.1	$336.20
1997	2.0	$342.92
1998	10.3	$378.24
1999	5.8	$400.18
2000	-0.5	$398.18
2001	6.0	$422.07
2002	-1.9	$414.05
2003	-3.1	$401.22
2004	2.3	$410.44
2005	3.5	$424.81
2006	5.1	$446.47
2007	6.4	$475.05
2008	7.7	$511.63
2009	7.5	**$550.00**

EXHIBIT "E"

Attached to and made a part of that certain Operating Agreement dated March 1, 2006, by and between Energen Resources Corporation, as Operator and Joseph A. Sommer, et al, as Non-Operator

GAS BALANCING AGREEMENT

1. Definitions.

(a) For the purpose of this Gas Balancing Agreement (the "Agreement"), the terms not otherwise defined herein shall have the same meaning as in the above-described Operating Agreement (the "Operating Agreement").

(b) "Balance" (or "Balanced") is the condition occurring when a Party has utilized or sold the same percentage of the cumulative gas production as such Party's Percentage Ownership therein.

(c) "Entitlement Share" is a share of total gas production from a Well or Lease which is proportionately equal to a working interest owner or owner's Percentage Ownership in such Well or Lease.

(d) "Overproduced" (or "Overproduction") is the condition occurring when a Party has utilized or sold a greater quantity of gas at any time (individually or through its gas purchaser) than if such Party was in Balance.

(e) "Underproduced" (or "Underproduction") is the condition occurring when a Party has utilized or sold a lesser quantity of gas at any given time (individually or through its gas purchaser) than if such Party was in Balance.

(f) "Party" (or "Parties") are the signatory Operator and Non-Operators to the Operating Agreement.

(g) "Percentage Ownership" is the working interest in the oil and gas rights underlying the area covered by the Operating Agreement in accordance with the percentage of participation as determined under the Operating Agreement.

(h) "Reservoir" shall mean a stratum of earth containing or thought to contain a common accumulation of oil and gas separately producible from any other common accumulation of oil and gas.

(i) "BTU" means a British Thermal Unit.

(j) "Mcf" means one thousand cubic feet.

(k) "Effective Date" is April 15, 2004

2. Right to Produce and Market Gas. In accordance with the terms of the Operating Agreement, each Party has specific rights relating to the taking and disposition of gas produced, including the right to take in kind its share of gas produced and to market or otherwise dispose of same. In the event any Party is not, at any time, taking or marketing its share of gas for any reason, then the terms of this Agreement shall automatically become effective.

3. Overproduction.

(a) Subject to the other provisions hereof, during any period when a Party is not marketing or otherwise disposing of or utilizing its full Percentage Ownership of gas produced, such gas, if any, not so marketed or disposed of shall be deemed to remain unproduced and stored within its Reservoir(s) for such Party, and the other Parties shall be allowed to produce a quantity of gas which would otherwise exceed their own Percentage Ownership of gas production, equaling the portion of gas production which such Party is not marketing or otherwise disposing of, and shall be allowed to take such gas production and require Operator to deliver the same to its or their purchaser(s).

The Party not marketing, or otherwise disposing of or utilizing its Percentage Ownership of gas produced shall be Underproduced by a quantity of gas equal to its Percentage Ownership of gas produced, less the quantity of gas taken by such Party or on behalf of such Party, and less such Party's share of gas vented or gas lost or used in Lease operations on the lease premises. Those Parties which elect to take the share of gas attributable to the Underproduced Party shall each take shares of gas attributable to each Underproduced Party, in the absence of any other agreement between them, in the direct proportion that each producing Party's Percentage Ownership bears to the total Percentage Ownership of all Parties taking an Underproduced Party's share, and each such Party so taking shall be considered Overproduced in the amount of such additional production attributed to it. Each Overproduced Party shall, subject to the terms of this Agreement, own all gas delivered to its purchaser(s) or taken for its own use.

4. Lease Liquids. All Parties shall share in and own liquid hydrocarbons recovered from all gas by primary separation equipment prior to processing in a gas plant in accordance with their respective Percentage Ownership in the Reservoir from which such gas was produced, whether or not such Parties are actually producing and marketing their Percentage Ownership in the gas produced.

5. Accounting of Balances. Each Party not taking or marketing its full share of the gas produced shall be credited with gas in the Reservoir equal to its full share of the gas produced under this Agreement, less its share of gas vented, or gas lost or used in Lease operations on the lease premises, and less that portion such Party took or delivered to its purchaser. The Operator will maintain a current account of the gas balance between the Parties and will furnish all Parties monthly statements within ninety (90) days after the end of the production month showing the Entitled Share of sales production of each Party, the quantity of gas delivered to pipeline purchaser(s) for the account of each Party, and the current month and cumulative over and under account of each Party. Balancing will be accounted for in Mcf's using a standard pressure base of 14.73 pounds per square inch and a standard temperature base of sixty degrees (60□) Fahrenheit. All statements and accounts with respect to gas quantities shall be made and maintained separately by Reservoir.

6. Right of Underproduced Party to Make Up Production. After written notice to the Operator at least thirty (30) days prior to the beginning of a calendar month, any Underproduced Party at any time shall be entitled to take additional quantities of gas, but limited to (i) fifty percent (50%) of such Party's Percentage Ownership of current gas production for gas produced during the months of April through September and (ii) twenty-five percent (25%) of such Party's Percentage Ownership of current gas production for gas produced during the months of October through March, until it has balanced the gas account to its Percentage Ownership with respect to a particular Reservoir, and provided that the right to take such additional quantities shall be in the proportion that its Percentage Ownership bears to the Percentage Ownership of all Underproduced Parties desiring to take more than their Percentage Ownership of gas produced. Each Overproduced Party shall reduce its respective share of production therein in the proportion that such Overproduced Party's Percentage Ownership bears to the total Percentage Ownership of all Overproduced Parties; provided, however, that no Overproduced Party shall be required to reduce its respective share of production by more than (i) fifty percent (50%) of its Percentage Ownership of current gas production during the months of April through September and (ii) twenty-five percent (25%) of its Percentage Ownership of current gas production during the months of October through March.

7. Settlement When Production Is Permanently Discontinued.

(a) If gas production from a particular Reservoir ceases and no attempt is made to restore production (or substitute therefor) within ninety (90) days, Operator shall distribute, within one hundred twenty (120) days of the date the Reservoir last produced, a statement of net unrecouped Underproduction and Overproduction ("□final accounting").

(b) Within sixty (60) days of receipt of such final accounting, each Overproduced Party shall remit to Operator for disbursement to the Underproduced Parties, a sum of money (which sum shall not include interest) equal to the amount actually received or constructively received under subparagraph (e) below, by such Overproduced Party. Such remittance shall be based on the number of Mcf's of Overproduction and shall be accompanied by a statement showing volumes and prices for each month with accrued unrecouped Overproduction. In calculating the amount due, the Overproduced Party will begin with the most recent month in which production was taken and calculate the amount due. Progressing backward in time, each month's value of production will be calculated until the production imbalance is zero. In the event the overproduced Party processed the gas at a gas processing plant for the extraction of liquid hydrocarbons, the values used for calculating cash settlement shall include proceeds received from the sale of liquids less actual transportation, processing and fractionation costs.

(c) Within thirty (30) days of receipt of any such remittance by Operator from an Overproduced Party, Operator shall disburse such funds to the Underproduced Party(ies) in accordance with the final accounting. The Operator shall calculate the overproduced value in total per Mcf and distribute to the underproduced parties on a weighted average dollar per Mcf basis. Operator assumes no liability with respect to any such payment other than remitting the funds received from the Overproduced Parties (unless such payment is attributable to Operator's Overproduction). It being the intent of the Parties that each Overproduced Party shall be solely responsible for reimbursing each Underproduced Party for such Underproduced Party's respective share of Overproduction taken by such Overproduced Party in accordance with the provisions herein contained. If any Party fails to pay any sum due under the terms hereof after demand therefor by Operator, Operator may turn responsibility for the collection of such sum to the Party or Parties to whom it is owed, and Operator shall have no further responsibility for collection.

(d) In determining the amount of Overproduction for which settlement is due, production taken during any month by an Underproduced Party in excess of such Underproduced Party's share shall be treated as make-up and shall be applied to reduce prior deficits.

(e) An Overproduced Party that took gas in kind for its own use, sold gas to an affiliate, or otherwise disposed of gas in other than a cash sale shall pay for such gas at market value using the methodology set forth in paragraph 7(b), even if the Overproduced Party sold such gas to an affiliate at a price less than market value.

(f) If refunds are later required by any governmental authority, each Party shall be accountable for its respective share of such refunds as finally balanced hereunder. In the event an Underproduced Party has not received a cash settlement at the time a refund is required by a governmental authority, the Overproduced Parties who sold the gas which is the basis for the refund shall be liable for and pay such refund and hold the Underproduced Party harmless from same.

8. Payment of Royalty. At all times while Gas is produced, each Party marketing gas hereunder will make settlement for the royalties based upon their takes. Each Party hereto agrees to hold each other Party harmless from any and all claims for royalty payments asserted by royalty owners to whom each Party is accountable.

9. Production Taxes. Each Party taking gas shall pay any and all production tax due on such gas.

10. Operating Expenses. The operating expenses are to be borne as provided in the Operating Agreement, regardless of whether all Parties are selling or using gas or whether the sales and use of each are in proportion of their respective Percentage Ownership interests in such gas.

11. Audits. Notwithstanding any provision to the contrary in this or any other agreement, for a period of three (3) years after the date that a gas balance statement is provided by Operator hereunder, any Underproduced Party shall have the right to audit an Overproduced Party's and Operator's records as to quantities and, in the event of cash balancing, prices received for gas produced. Any Overproduced Party shall have the right to audit both the Underproduced Party's and Operator's records as to quantities of gas produced. All such audits shall be at the sole cost and expense of the auditing Party.

12. Scope, Effective Date and Term. The provisions of this Agreement shall separately apply to each Reservoir. This Agreement shall become effective for all purposes as of the Effective Date and shall remain in force and effect as long as the Operating Agreement is in effect and thereafter until all accounts between/among the Parties maintained pursuant to this Agreement are settled in full. This Agreement shall inure to the benefit of and be binding upon the Parties and their respective successors and assigns.

13. Deliverability Tests. Nothing herein contained shall be construed as denying Operator the right, from time to time, to conduct deliverability tests required by governmental authority, or as denying any Party the right, from time to time, with at least fifteen (15) days written notice to Operator, to produce and take or deliver to its purchaser its full share of the allowable gas production to meet deliverability tests required by its gas purchaser or governmental authority.

14. Nominations. On or before the 10th day of each month prior to the month of production, each Party shall give Operator sufficient data either to nominate such Party's respective share of gas to the transporting pipeline(s) or, if Operator is not nominating such Party's gas, to inform Operator of the manner in which to dispatch such Party's gas. Except as and to the extent caused by Operator□s negligence or willful misconduct, Operator shall not be responsible for any fees and/or penalties associated with imbalances charged by any pipeline to any Underproduced or Overproduced Party(ies) other than Operator□s proportionate share of such fees and/or penalties.

15. Conflicts with Operating Agreement. To the extent the provisions of this Agreement conflict with provisions of the Operating Agreement, the provisions of this Agreement shall control.

16. Balancing Area. If this Agreement covers more than one well or Reservoir (the "Balancing Area"), it shall be applied as if each Balancing Area were covered by separate but identical agreements.